

State of Delaware
Public Service Commission

IN THE MATTER OF INTEGRATED) DOCKET NO. 06-241
RESOURCE PLANNING FOR THE)
PROVISION OF STANDARD OFFER)
SUPPLY SERVICE BY THE DELMARVA)
POWER & LIGHT COMPANY UNDER 26)
DEL. C. SECTION 1007(c) & (d):)
REVIEW AND APPROVAL OF THE)
REQUEST FOR PROPOSALS FOR THE)
CONSTRUCTION OF NEW)
GENERATION RESOURCES UNDER 26)
DEL. C. SECTION 1007(d))

IN THE MATTER OF THE PROVISION) DOCKET NO. 04-391
OF STANDARD OFFER SUPPLY TO)
RETAIL CONSUMERS IN THE SERVICE)
TERRITORY OF DELMARVA POWER)
& LIGHT COMPANY (Filed on August 1,)
2006))

COMMENTS OF NRG ENERGY, INC. ON INDEPENDENT CONSULTANT'S
REPORT

I. INTRODUCTION

NRG Energy, Inc. (“NRG”) is pleased to offer its comments to the Delaware Public Service Commission (“PSC” or the “Commission”) on the “Initial Report Regarding Delmarva Power & Light Company’s Proposed RFP” (“Report”), dated September 18, 2006 and related “Independent Consultant Markup of September 27, 2006 to Delmarva Proposed RFP” (“Markup”) ¹, and prepared for the Commission by the consulting team of New Energy Opportunities, Inc., Merrimack Energy Group, Inc., La Capra Associates, Inc. and Edward L. Selgrade, Esq. (collectively, the “Independent Consultant”). The Report and Markup provide an analysis of a Compliance Filing and

¹ NRG may provide additional comments on the Markup by the amended October 6, 2006 deadline specified by the Commission.

Proposed Request for Proposals (“RFP”), filed with the Commission on August 1, 2006 by Delmarva Power & Light Company (“Delmarva”) in the above-captioned dockets. NRG has been an active participant in the subject proceedings. NRG participated in the August 18, 2006 Public Workshop, and submitted Initial Comments on August 17, 2006 and Supplemental Comments on August 31, 2006 (“Supplemental Comments”).

II. COMMENTS OF NRG

A. General Comments

Overall, NRG finds the Report to be well-informed and clearly written. While not conceding any of the points raised in its Supplemental Comments, NRG generally accepts the Independent Consultant’s analysis and conclusions as set forth in the Report. In the interest of brevity, NRG will not recount its many areas of agreement (and minor disagreements) with the Report, and will confine its comments to the remaining areas of material disagreement. In doing so, however, NRG does not wish to appear unappreciative of the obvious effort expended by the Independent Consultant in analyzing Delmarva’s proposed RFP and preparing the Report. NRG wishes to thank the Independent Consultant for its efforts and to thank the Commission for the opportunity to offer these further comments.

B. Size of the RFP

Delmarva has proposed to limit the amount of electrical capacity and associated energy, ancillary services and environmental attributes to no more than 200 MW. In its Supplemental Comments, NRG provided a detailed critique of the proposed 200 MW size limit.² NRG pointed out that Delmarva’s proposal rested upon a faulty justification

² Supplemental Comments at pp. 4-11.

and was inconsistent with the express terms of the Delaware Electric Utility Retail Customer Supply Act of 2006 (“EURCSA”). NRG recommended that the size limit be increased to a level commensurate with a new base load power plant of 500-600 MW, or more.³

In response, the Report recommends a size limit of 400 MW, subject to a proportional loss of five points in the bid evaluation process for non-dispatchable capacity offered above 200 MW. The Independent Consultant’s rationale for this new proposal is not clearly articulated. Perhaps the Independent Consultant views its proposal as a compromise between the concerns of NRG (and another commenter) that a 200 MW PPA would not support the financing necessary to construct and operate a 500-600 MW base load generating plant, as required by the EURCSA, and Delmarva’s concern that too large a contractual commitment would expose its Standard Offer Service (“SOS”) ratepayers to price risk if wholesale electric power prices decline or are stagnant.⁴ The Report states: “we believe we have sufficient information to conclude that 600 MW or more is too large a contract from a customer exposure perspective”⁵ but the Report does not identify this information or explain why the Independent Consultant believes a 600 MW PPA would present unacceptable price risks to SOS customers.

NRG respectfully submits that the Independent Consultant’s position lacks sufficient foundation, is contrary to the express requirements of EURCSA, and should be rejected by the Commission. Specifically, the Report offers no quantitative justification for a 400 MW limit. No analysis is presented to show that SOS customers will be

³ *Id.*, p. 5.

⁴ Report at p. 8.

⁵ *Id.*, p. 9.

exposed to unacceptable price risks with PPAs above this quantity. The proposed 400 MW limit appears to be a “split the difference” compromise between NRG’s planned integrated gasification, combined-cycle (“IGCC”) plant of approximately 630 MW and Delmarva’s original, flawed proposal to limit the RFP to only 200 MW. Such a compromise provides only the illusion of fairness and does not serve EURCSA’s overarching goal of providing low cost and reliable electric service to Delmarva’s SOS customers and a framework for a robust and competitive RFP process that will benefit Delawareans.

The Report also observes that the 400 MW limit “would represent 80% of a 500 MW plant and 63.5% of a 630 MW plant”⁶ and goes on to claim that “[w]e believe that this subscription percentage would leave a reasonable amount of subscription and/or market risk for project developers in this context.”⁷ The Independent Consultant cites no authority to support the reasonableness of this conclusion with respect to development of an IGCC plant, and NRG is unaware of any. Before accepting such an assertion and imposing a size limit well below the scale of a commercial base load facility, NRG respectfully suggests that the Commission require the Independent Consultant to undertake an analysis of the ability of developers to obtain financing for a base load power plant, using innovative technology, under exposure to 63.5% subscription and/or merchant risk. As a party actively engaged in the development, financing, construction and operation of power plants – and the marketing of wholesale electric power – NRG is skeptical that such an analysis will support the proposed 400 MW size limit.

⁶ Report at p. 9.

⁷ *Id.*

At its core, the proposed 400 MW limit will impose additional costs and risks on any developer of a commercial scale base load facility in Delaware. Ultimately, Delmarva's SOS customers will bear the cost, either as the result of a sub-optimal size plant being constructed or as the result of more costly financing for a plant of optimal size. A 600 MW PPA will fully mitigate these risks. No substantive evidence has been introduced into the record of these proceedings that SOS customers will be better off with a PPA of any lesser amount.

As noted above, the proposed 400 MW size limit is also subject to a proportional loss of five points in the bid evaluation process for non-dispatchable capacity offered above 200 MW.⁸ Again, the Independent Consultant's rationale appears to be reduction in price risk to Delmarva's SOS customers. Requiring a plant's output to be subject to dispatch may limit the exposure of Delmarva and its SOS customers to being required to purchase energy priced at above-market levels. But again, the Independent Consultant has provided no support for the quantitative level of 200 MW, beyond which points may be deducted from bids that clearly advance the EURCSA objectives. Moreover, the Independent Consultant has not clearly explained what is contemplated by the term "dispatchability."

In its Supplemental Comments, NRG explained in detail why Delmarva's rationale for a 200 MW size limit was inconsistent with the objectives and intent of Delaware legislators under the EURCSA. While thorough and thoughtful overall, the Report does not address NRG's reasoning on this important issue. Accordingly, no sound basis for a 200 MW limit of any kind has been advanced. Moreover, the Independent Consultant has advanced no technological rationale for its new, 200 MW

⁸ Report at p. 35.

limit on non-dispatchable power. The Report does not address the ability of a commercial-scale IGCC plant to be safely, reliably and efficiently dispatched down to a minimum load level of 200 MW. Before the Commission takes the step of imposing such a requirement, NRG respectfully suggests that it develop the requisite record that such requirement is safe, technically feasible and likely to minimize costs. No such record exists today.

NRG also notes that the Independent Consultant's requirement for dispatchability above 200 MW may be inconsistent with EURCSA, which requires that Delmarva's RFP recognize the value of "proposals that utilize new or innovative base load technologies."⁹ The statute specifically mentions base load technologies. Had the legislature intended the RFP to promote load-following, cycling or intermediate load technologies, the statute would have said so. It does not.

The Report does not explain what is meant by "dispatchable" but this term is commonly understood to require the ability to change output on short notice, as directed by the system controller. Base load plants using innovative technology (*e.g.*, IGCC, super-critical steam pulverized-coal, or third generation nuclear plants) may be unable to be operated in this manner, consistent with good utility practice. NRG respectfully recommends that the Commission reject the Independent Consultant's dispatchability proposal, unless and until a record is developed as to what is technically feasible, what is consistent with EURCSA and what (if anything) is necessary to protect SOS customers from market risk. NRG would welcome the opportunity to participate in a technical workshop with the Independent Consultant and the Commission staff to consider what may be achievable in this regard for an IGCC base load plant.

⁹ 26 Del. C. §1007(d)(1)a.

C. Imputed Debt Offset

Delmarva proposed in the RFP that the evaluation of bids from a cost viewpoint be subject to a cost factor relating to a proposed PPA's "Imputed Debt Offset" reflecting purported rating agency concerns regarding long term power purchase agreements.¹⁰ NRG, in its Supplemental Comments, provided detailed reasons why an imputed debt offset should not be applied as a factor in evaluating bids received under the RFP¹¹ which are accurately summarized by the Independent Consultant in the Report.¹²

While the Independent Consultant offers no rebuttal of NRG's points, it nonetheless recommends keeping the Imputed Debt Offset and de-emphasizing its role to one of a "sensitivity" following the performance of the "Detailed Evaluation Analysis".¹³ The Independent Consultant does not explain the role of a "sensitivity" factor in the bid selection process and articulates no rationale for choosing this "Alternative 2" and applying a 30% "risk factor" in undertaking this questionable calculation.¹⁴ As with the suggestion on the size of the RFP discussed above, the Independent Consultant's recommendation appears to be an attempt to reach a compromise between the position of Delmarva and that of NRG and another commenter. However, the proposed compromise is not justified on any bases enunciated by the Independent Consultant and, respectfully, is not an appropriate outcome in the context of the EURCSA goals for Delaware generation.

¹⁰ RFP § 2.3.6, p. 11.

¹¹ Supplemental Comments at pp. 16-18.

¹² Report at p. 34.

¹³ Report at 32-34.

¹⁴ Markup at Sec. 2.3.6.

First, by maintaining the concept of an Imputed Debt Offset, the Independent Consultant accepts the assertion that a long-term PPA with assured cost recovery through retail rates will be treated as debt by all of the major rating agencies. Although a Standard and Poors' publication is attached to the Report, no evidence is provided that any of the other rating agencies (*e.g.*, Moody's) would impute debt to Delmarva in connection with a PPA approved for retail rate pass-through such as that proposed in the RFP. In fact, Moody's has stated in its 2005 report, *Rating Methodology: Global Regulated Electric Utilities*, that:

“[s]ome utilities have the ability to pass through the cost of purchasing power under PPAs to their customers. As a result, the utility takes no risk that the cost of power is greater than the retail price it will receive. Accordingly, Moody's regards these PPA obligations as operating costs with no long-term debt-like attributes.”

Hence, it seems inappropriate to “charge” against a proposal a cost which cannot be definitively shown to exist. Second, the Imputed Debt Offset will disproportionately affect base load generators in the “sensitivity” process given the higher capacity payment stream for such generators (*i.e.*, the “debt” which Delmarva imagines will be imputed to it) as compared to other generating technologies relying on more intermittent energy payments. This runs contrary to the policy of EURCSA to recognize the value of “proposals that utilize new or innovative base load technologies” as opposed to penalize such proposals as implied by the Independent Consultant's Alternative 2.¹⁵

Finally, there may be some merit in a proposal (similar to that of the Oregon Public Utilities Commission and cited in the Report) that would require Delmarva to go

¹⁵ 26 Del. C. §1007(d)(1)a.

back to the rating agencies to determine the impact of a proposed PPA on its credit rating. One could reasonably expect that Delmarva would have an unambiguous economic incentive to argue that a proposed PPA had no “debt-like” characteristics given the pass-through nature of the obligations. This would suggest that if Delmarva were to argue to the rating agencies that a PPA should be treated as debt, it may only be doing so in order to advance a self-build agenda.

In light of the foregoing, NRG respectfully requests that the Commission direct Delmarva to remove the Imputed Debt Offset as any type of factor in this RFP process.

D. Economic Evaluation Methodologies and Modeling Issues

Transparency is undoubtedly the key to a *competitive* RFP process (a bedrock principle underlying EURCSA). Delmarva provides virtually no information in the RFP on the modeling inputs or methodology, and effectively asks bidders to trust that bid evaluations and modeling will be completed in a just and reasonable manner. NRG, in its Supplemental Comments, went into substantial detail on its concerns with the skeletal methodology suggested by Delmarva with respect to undertaking the economic evaluation of bids and suggested that all bidders be given the opportunity to examine the model to be used by Delmarva to encourage transparency.

However, the Independent Consultant, after being brought “behind the curtain” by Delmarva and its consultant, ICF, seeks to give assurance in the Report that “all is well” with the model (despite the fact that some of the key metrics have not yet been resolved)¹⁶ and ask bidders to trust that the Independent Consultant will ensure that the modeling is done in a reasonable manner to produce accurate results. Although NRG has confidence in the impartiality of the Independent Consultant in this process, there is no

¹⁶ Report at p. 38.

adequate substitute for full transparency with respect to the assumptions and formulas which create the models and in turn on which the RFP outcome will depend. As mentioned in the Supplemental Comments, NRG has a serious concern that the lack of long-term liquidity in the power and fuel markets will unduly penalize those bidder who propose longer term PPAs to support the construction of capital-intensive base load generation. Nothing in the Report allays this concern. Accordingly, unless there is full transparency, bidders cannot be confident that their bids are being appropriately evaluated on a just and reasonable basis while taking into account all of the economic factors appropriately considered in a process such as this. Therefore, NRG respectfully requests that the Commission order that the models to be used to undertake the economic evaluation of proposals be made available to all bidders on a non-discriminatory basis.

E. Change in Law

Delmarva, in its draft Key Commercial Terms of Power Purchase Agreement (“Term Sheet”), indicated that Seller should bear all risks and costs of compliance with laws that may be changed or enacted at any time during the contract term.¹⁷ NRG took issue with this concept in its Supplemental Comments as noted by the Independent Consultant.¹⁸ Nonetheless, the Independent Consultant states in its report that “[i]t is standard industry practice in long term PPAs that future environmental compliance costs that are not in the nature of a tax, pursuant to existing or future laws and regulations, would be a Seller responsibility”¹⁹ and thereby suggests that only costs in the nature of a

¹⁷ Term Sheet at p. 13.

¹⁸ Report at p. 53.

¹⁹ *Id.*

Btu or carbon tax be passed through to the Buyer under the PPA.²⁰ NRG respectfully disagrees with this assertion as a general matter and contends that the lack of a mechanism for cost recovery in this RFP is specifically at cross-purposes with the objective and policy of EURCSA.

As an initial observation, there are many domestic and international long-term PPAs and contracts for differences where the buyer compensates the seller following changes in law. This is particularly the case where the applicable facility may not be constructed but for the existence of such a PPA, as is the case under this RFP. The Seller is bidding, in accordance with the RFP, under a set of laws and regulations dictating certain environmental requirements that will necessitate capital expenditures by Seller in order to comply. The level of those expenditures is ultimately reflected in the bid price against which Seller and Buyer may transact. Where additional capital expenditures are required due to a future change in law or regulation, a fundamental assumption underlying the parties' economic bargain (*i.e.*, the capital cost of regulatory compliance) has been altered through no fault or action of Seller. The Seller will need to make the capital expenditure in order to continue operations. The necessary capital must come from either debt or equity sources, as there will be no insurance proceeds available (as might be the case in other situations where the need for capital expenditures may arise through no fault of Seller). If there are no means to recover the capital cost corresponding to such required expenditures, Seller may not be able to finance them and may have no other option but to shut down its facility. It is inconceivable that, given that the purpose of EURCSA to encourage the development of new generation facilities in Delaware under certain conditions (with certain enumerated benefits for the state), a

²⁰ Markup at Term Sheet p. 16.

situation could arise through no fault of Seller and not otherwise subject to Seller's control or influence, where Seller would be effectively required as a rational economic actor to shut its facility because economic operation was no longer feasible due to the occurrence of a change in law. Therefore, NRG respectfully submits that the Independent Consultant erred in suggesting only that a cost recovery mechanism be implemented in the context of the imposition of an "energy tax" without further providing that increased capital costs imposed by a change in law or regulation should be addressed through an equitable adjustment to the capacity price. NRG respectfully urges the Commission to provide for equitable cost recovery for the Seller in the context of changes in law. Finally, in financeable energy projects, lenders also require that change in law risk is allocated between the parties to power purchase agreements in such a way as to preserve the economic bargain for the seller/debtor. Potential bidders will be concerned that the Independent Consultant's recommendation on change in law risk will undermine a Seller's ability to obtain project funding. This will potentially have a chilling affect and reduce the amount of credible bids (and therefore competition to the benefit of Delaware's citizens) in response to the RFP process.

F. Unit Contingent Energy

While NRG favors the approach suggested by the Independent Consultant regarding the use of a unit contingent product when compared to the system firm product proposed by Delmarva, NRG disagrees with the assertion that "[t]he Seller should not have the option to provide replacement power when its plant is unavailable or is not called upon to produce energy . . .".²¹ The rationale given by the Independent

²¹ Report at p. 12. With respect to the comment regarding a Seller option to provide replacement power when its plant is not called upon to produce energy, NRG did make this suggestion. There would be no reason to deliver replacement power where Delmarva did not want any power from the facility, and the facility was otherwise available.

Consultant for this statement is that Seller could, in effect, arbitrage the market price against the contract price and thereby deprive Delmarva and its customers of an (unspecified) economic benefit.²² This, of course, should not be an issue as the PPA could easily be crafted to provide the Seller with the option to provide the energy at the lower of market price (in a specified market) or the contract price, in the context of replacement power. Delmarva's SOS customers would be held harmless with respect to energy prices under such an arrangement and may realize lower energy costs.

NRG proposes that for every hour that Seller exercises this option, its facility would be deemed available for the various capacity payment calculations. Although SOS customers would have to make the capacity payments, the overall financing cost of the facility would likely be reduced because the risk of a shortfall in capacity payments would be mitigated. SOS customers would realize the benefits of lower financing costs, which would offset the direct cost of continuing to make capacity payments when the Seller delivers energy from an alternative source. NRG respectfully requests that the Commission require that Delmarva incorporate this option into its PPA, as it will promote the efficient use of resources, is likely to reduce energy costs to SOS customers, and is unlikely to impose a material burden in terms of capacity costs.

G. Delivery Point and Transmission Losses and Congestion

Delmarva had proposed that the Delivery Point for projects in its RFP would be the Delmarva Zone and that Delmarva would not be responsible for designating proposed projects as a network resource. NRG proposed an alternative Delivery Point in its Supplemental Comments, but the Independent Consultant appears to fully accept Delmarva's position. The Report simply concludes: "[w]e believe that it is reasonable . .

²² *Id.*

. for Delmarva to take into consideration the risk of marginal losses and congestion in its bid evaluation.”²³

Although NRG agrees that marginal transmission losses and congestion should be considered in the bid evaluations, NRG respectfully submits that the Independent Consultant has not addressed the issue fully. NRG remains concerned that Delmarva may be able to exercise an undue preference with respect to any self-build option under the IRP (and other generation that Delmarva owns or controls) as compared to Sellers bidding under the RFP. If Delmarva designates other generating plants as network resources, why is it proposing not to afford the same treatment to projects selected in the RFP? No justification for disparate treatment has been offered, either by Delmarva or the Independent Consultant. NRG requests that the Commission require Delmarva to treat such projects comparably to other projects that it owns or controls.

With respect to marginal transmission losses and congestion, NRG is concerned that Delmarva will model the transmission system as essentially static, and will not take into account transmission upgrades required of Sellers by PJM as part of the interconnection process. NRG respectfully suggests that the Commission requires that Delmarva’s evaluation of marginal losses and congestion fully take into account these network upgrades. Moreover, in situations where the difference between a winning and losing bid is determined by Delmarva’s modeling of transmission losses and congestion, the interests of Delmarva’s SOS customers would best be served if the competing bidders were offered the right, but not the obligation, to propose further transmission reinforcements at their own expense in order to mitigate losses and congestion. It would

²³ Report at p. 15.

benefit the overall RFP process for the Commission to require Delmarva to incorporate such an option into its bid solicitation.

Finally, NRG reminds the Commission and the Independent Consultant that transmission losses and congestion can be affected by the retirement of existing generating units. Bidders with existing generation may be able to reduce marginal losses and congestion by retiring older units, and should be afforded the opportunity to consider such action if Delmarva's bid evaluation reveals that losses and congestion may result in their bid not being selected. The interests of Delmarva's SOS customers would be served by requiring that such flexibility be added into the RFP process.

III. CONCLUSION

The Independent Consultant has done an admirable job in addressing many of the evident shortcomings in Delmarva's proposed RFP. If all of the Independent Consultant's recommendations were implemented, the RFP would be no doubt be closer to the document the legislature envisioned when it passed EURCSA.


However, as set forth above, there would remain several material shortcomings in the RFP. The size limit proposed by Delmarva as modified by the Independent Consultant remains too small to meet the policies underlying EURCSA. The Imputed Debt Offset and opaque modeling methodology do not reassure bidders that the RFP will be an equitable and transparent process. The proposed contractual allocation of risks with respect to potential changes in law does not appear to be balanced. The treatment of Sellers with respect to network resource designation appears to be potentially unduly discriminatory, and the evaluation of marginal transmission losses and congestion can be improved to the benefit of the SOS customers.

A just and reasonable resolution of the foregoing issues, and the other issues identified herein and in NRG's Supplemental Comments, are critical to conducting a process that will meet the legislative goals that inspired the enactment of EURCSA.

NRG thanks the Commission for the opportunity to provide these comments and looks forward to continuing to participate in this matter.

Respectfully submitted,

NRG ENERGY, INC.

A handwritten signature in black ink, appearing to read "Caroline Angoorly", written in a cursive style.

By: Caroline Angoorly
Vice President & General Counsel, NE

October 2, 2006